

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)

PAEDICK GHARAPANIANSE,)
dba Liquor Sevan Mini Mart¹)

Petitioner)

Account Number SR AC 100-911063²
Case ID 568598

Burbank, Los Angeles County

Type of Business: Liquor store

Audit period: 07/01/07 – 06/30/10

<u>Item</u>	<u>Disputed Amount</u>
Unreported taxable sales	\$886,468
Negligence penalty	\$ 7,911
Interest relief	\$ 36,280 ³

	<u>Tax</u>	<u>Penalty</u>
As determined	\$84,605.51	\$8,460.57
Post-D&R adjustments	- 5,497.52	- 549.80
Proposed redetermination	\$79,107.99	\$7,910.77
Less concurred	- 875.23	00.00
Balance, protested	<u>\$78,232.76</u>	<u>\$7,910.77</u>
Proposed tax redetermination	\$ 79,107.99	
Interest through 11/30/16	36,280.10 ⁴	
Negligence penalty	7,910.77	
Total tax, interest, and penalty	\$123,298.86	
Payment	- 500.00	
Balance due	<u>\$122,798.86</u>	

Monthly interest beginning 12/01/16 \$ 393.04

¹ Petitioner changed the business name from Danny's Wine Cellar to Liquor Sevan Mini Mart when the business location moved from Los Angeles to Burbank in April 2014.

² Petitioner's account number was changed from "SR AS 100-911063" to "SR AC 100-911063" due to the move of the business location from Los Angeles to Burbank in April 2014.

³ Petitioner has not stated a specific period for which he requests relief of interest. Thus, we show the entire amount of accrued interest through November 30, 2016, as the disputed amount. Also, we note that interest will continue to accrue until the entire amount of tax is paid.

⁴ The interest of \$36,280.10 is net of \$2,947.81, the amount of interest we compute for the period for which we recommend relief, April 1, 2012, through October 31, 2012.

1 This matter was scheduled for Board hearing in February 2015, but it was deferred at the
2 request of the Appeals Division in order to issue a Supplemental Decision and Recommendation. It
3 was rescheduled for hearing in February 2016, but was postponed at petitioner's request to allow time
4 to hire a new representative. It was rescheduled for Board hearing in July 2016, but was postponed at
5 petitioner's request due to a death in the family.

6 UNRESOLVED ISSUES

7 **Issue 1:** Whether any additional adjustments to the amount of unreported taxable sales are
8 warranted. We find that no additional adjustments are warranted.

9 Petitioner has operated a liquor store since June 2007. For audit, petitioner provided his federal
10 income tax returns and a sales summary for the first quarter of 2010. According to petitioner, he adds
11 the cash in the cash register at the end of each day to the credit card receipts to compute his daily total
12 sales, and estimates his taxable sales as a percentage of his computed total sales for reporting purposes.
13 The Business Tax and Fee Department (Department), formerly the Sales and Use Tax Department,
14 found no material differences between the gross receipts reported on petitioner's income tax returns
15 and the total sales reported on his sales and use tax returns. Using petitioner's reported total sales and
16 the costs of goods sold reported on the income tax returns, the Department computed book markups of
17 17 percent for 2007, 99 percent for 2008, and 116 percent for 2009. Given inconsistent book markups
18 that were either lower or much higher than expected, the Department decided to prepare a markup
19 analysis to establish audited sales.⁵

20 The Department sent requests for information regarding petitioner's merchandise purchases to
21 21 suppliers in petitioner's area. Of the 18 vendors that responded, 13 provided petitioner's purchase
22 information for the audit period, and five confirmed that petitioner did not purchase from them. The
23 Department used these responses to establish audited taxable merchandise purchases of \$991,807 for
24 the audit period, which it reduced by 1 percent for self-consumption, and by 1 percent for shrinkage, to
25 establish audited costs of taxable merchandise sold of \$972,070. As explained in more detail below,
26

27 ⁵ Markups that are either unusually low or unusually high raise concerns about the accuracy of recorded and reported sales.
28 Markups that are lower than expected often indicate unrecorded sales. Markups that are unusually high often indicate that
recorded purchases are understated, and thus raise questions regarding the accuracy of recorded and reported sales.

1 we have recommended that the shrinkage allowance be increased to 2 percent, which resulted in a
2 reduction of \$9,819 to the audited costs of taxable merchandise sold, from \$972,070 to \$962,251.

3 Because petitioner failed to provide any merchandise purchase invoices, the Department was
4 unable to compare costs for specific items with petitioner's shelf prices to compute markups. Based on
5 a survey of the retail trade published by the U.S. Census Bureau, which notes that the average markup
6 for petitioner's industry was 38.09 percent in 2007, the Department concluded that petitioner's markup
7 was 38.09 percent for the audit period in the original audit. However, based on petitioner's assertion
8 on appeal that his average markup was 33 percent, the Department added the markup of 33 percent to
9 audited costs of taxable merchandise sold of \$962,251 to establish audited taxable sales of \$1,279,794
10 in the most recent reaudit, which exceed petitioner's reported taxable sales by \$886,468.

11 Petitioner contends that the allowance for shrinkage should be further increased by \$37,459 to
12 account for additional inventory losses due to robberies and employee thefts, earthquakes, 30 accidents
13 resulting in bottles falling off shelves, and water damage caused by a car hitting a fire hydrant.
14 Petitioner provided three police reports, a form containing traffic collision information, and schedules
15 he prepared listing dates of the earthquakes, bottle breakages, and his calculations of the inventory
16 losses resulting from those incidents (without any documentation such as insurance claims or other
17 records prepared at the time the losses occurred). Petitioner contends that the allowance for self-
18 consumption should be increased by \$16,936 to account for gifts of alcohol to four individuals at their
19 events. In support, petitioner provided a list of the events and the value of the alcohol he allegedly
20 gave away, with the alleged recipients' notarized signatures appearing next to the corresponding
21 events. Additionally, petitioner contends that an unspecified increase to the allowance for self-
22 consumption is warranted for his donations to the Saint John Armenian Church and its members.
23 Petitioner provided a letter from that church acknowledging petitioner's kindness in helping
24 unfortunate members of the church and the community. Petitioner contends that he is entitled to an
25 inventory adjustment of \$174,747 based on an inventory report dated May 24, 2011, which lists the
26 items in petitioner's inventory as of June 30, 2010. Additionally, petitioner contends that audited
27 taxable merchandise purchases from two vendors, Jetro and Santa Monica Distributing, included
28 exempt food items. In support, petitioner provided an email listing the file names for 51 attachments

1 showing purchase transactions totaling \$51,412 from Jetro in 2008. Since the file names for purchase
2 transactions totaling \$10,847 did not include the words “cigarette” or “tobacco,” petitioner contends
3 that 21.10 percent of the purchases ($\$10,847 \div \$51,412$) represent nontaxable items. Petitioner also
4 provided seven cash register receipts from Jetro on which he had written amounts that he claims
5 represent purchases of nontaxable items. Lastly, in a Request for Reconsideration dated December 28,
6 2014, petitioner raised the argument that, because of competition and promotions by the new
7 management, and because he filed bankruptcy in 2011, his actual markup was much lower than the
8 markup of 33 percent that the Department had accepted based on his previous assertions at the appeals
9 conference in November 2013.

10 Regarding petitioner’s contentions that adjustments to the audited costs of goods sold are
11 warranted, we find that the police reports provided to support an increase in the allowance for
12 shrinkage indicate that some cash was stolen, but none of the documentation provided shows any
13 losses of taxable merchandise. However, in preparing this case for Board hearing, we noted that
14 petitioner claims losses from six earthquakes during the audit period, and found that two of the
15 earthquakes, for which petitioner claims losses of \$5,590, were reported to have caused damage in
16 petitioner’s area. Therefore, giving petitioner the benefit of the doubt in the absence of supporting
17 documentation, we recommended that the shrinkage allowance be increased from 1 percent to
18 2 percent of the costs of taxable merchandise available for sale, an additional allowance for losses of
19 \$9,819. We find that the shrinkage allowance of \$19,638 for the audit period, or \$546 per month, is
20 reasonable, and no adjustment for additional shrinkage is warranted.

21 We find that the list of “gifts” of alcohol that petitioner provided to support an increase to the
22 allowance for self-consumption is not reliable because, although it contains notarized signatures, it
23 does not contain statements acknowledging receipts of alcohol by the individuals signing the list.
24 Regarding the letter from the church, we note that it does not suggest or provide specific information
25 regarding any donations of taxable merchandise by petitioner. Therefore, we conclude that the
26 allowance for self-consumption of \$9,918 for the audit period, or \$276 per month, is reasonable, and
27 no adjustment for additional self-consumption is warranted. While petitioner contends that he is
28 entitled to an inventory adjustment of \$174,747 based on an inventory report dated May 24, 2011, we

1 question the reliability of the report because it is dated almost a year after the inventory date (June 30,
2 2010), and it does not identify the name of the preparer. Furthermore, we note that petitioner failed to
3 provide any information regarding his inventory at the beginning of the audit period, and petitioner's
4 federal income tax returns, on which he reported ending inventories of \$125,000 for 2007, \$120,000
5 for 2008, and \$103,627 for 2009, suggest that petitioner's inventory decreased slightly during the audit
6 period. Since we are unable to determine whether there was any change in inventory during the audit
7 period, we conclude that there is no basis for recommending an adjustment for an inventory increase.

8 Regarding petitioner's contention that the audited costs of goods sold include purchases of
9 exempt food items, we examined the seven receipts totaling \$2,205 from Jetro that petitioner provided,
10 and found that purchases of exempt food items totaling \$30 were shown in one receipt. Based on the
11 examination, we concluded that the amounts of exempt food items that petitioner purchased from Jetro
12 were immaterial, and such immaterial purchases of nontaxable items would have been offset by
13 purchases of taxable items from other unknown vendors that were not accounted for in the audit.

14 Regarding petitioner's contention that his actual average markup was much lower than the markup of
15 33 percent that he asserted earlier, we find that petitioner has provided no documentation or other
16 evidence to support a lower markup, and conclude that no reduction to the markup is warranted. In
17 sum, we conclude that the results of the second reaudit are reasonable, and we recommend no
18 additional adjustments.

19 **Issue 2:** Whether petitioner was negligent. We conclude that he was.

20 The Department imposed the negligence penalty because petitioner failed to maintain
21 documents such as cash register z-tapes and summary reports to support his recorded total and taxable
22 sales, and because the understatement of reported taxable sales is substantial. Petitioner states that he
23 had no ill intent to falsify his records, and in order to save money, he self-prepared the books and
24 records instead of employing an accountant to do so. Thus, while petitioner concedes that he made
25 careless mistakes, he contends that he was not negligent.

26 We note that the only records provided for audit were petitioner's federal income tax returns
27 and a sales summary for the first quarter of 2010, and find that petitioner's failure to provide source
28 documents, such as cash register Z-tapes and purchase invoices, and other basic accounting records is

1 strong evidence of negligence in recordkeeping. A comparison of unreported taxable sales of
2 \$886,468 with petitioner's reported taxable sales of \$393,318 shows a reporting error rate of
3 225 percent, which indicates that petitioner reported less than one-third of his taxable sales. Moreover,
4 we note that petitioner's reported taxable sales were less than half of his taxable merchandise
5 purchases of \$991,807, and conclude that petitioner's failure to notice this discrepancy and take
6 immediate steps to correct his obvious reporting errors is strong evidence of negligence in reporting.
7 We find that petitioner's bookkeeping and reporting errors (the absence of records, the magnitude of
8 the understatement, and reported taxable sales that were less than half of taxable merchandise
9 purchases) cannot be attributed to his bona fide and reasonable belief that his bookkeeping and
10 reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law.
11 Under such circumstances, the imposition of a negligence penalty in a first-time audit is appropriate.
12 (*Cf. Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

13 **Issue 3:** Whether relief of interest is warranted. We conclude that relief is warranted for the
14 period April 1, 2012, through October 31, 2012.

15 On February 19, 2015, petitioner filed a request for relief of interest, signed under penalty of
16 perjury, on the basis that there were multiple unreasonable delays in the course of the appeals process.
17 Petitioner contends that the two-year period from the issuance of the Notice of Determination on
18 March 17, 2011, until March 15, 2013, when he received a letter informing him that his petition would
19 be referred to the Appeals Division, constitutes an unreasonable delay. Petitioner also contends that
20 unreasonable delays occurred when another six months lapsed before he received the Notice of
21 Appeals Conference dated September 13, 2013, and when two-and-a-half months lapsed after he
22 submitted additional evidence to the Department on January 13, 2014, until the D&R was issued on
23 April 23, 2014.

24 In our examination of the Board's records, we noted that the case was assigned to the Board's
25 Culver City District Office for the 18-month period from April 2011 through mid-October 2012. We
26 contacted that office and were informed that audit staff contacted petitioner in May 2011 to request
27 additional evidence, and after petitioner provided 13 pages of supporting documents in November
28 2011, the audit staff decided to contact petitioner's vendors in April 2012 to obtain petitioner's

1 purchase information for 2011. In July 2012, after reviewing all of the available evidence, the audit
2 staff concluded that no additional adjustments were warranted, and the case file was sent to the
3 Settlement Section in October 2012 (the matter had been accepted into the settlement program in June,
4 2011). The Culver City District Office has advised that it strives to complete these types of
5 assignments within four months. Here, the District promptly requested supporting evidence from
6 petitioner's representative in May, 2011, but the representative did not provide such evidence until six
7 months later, in November 2011. Applying the District's four-month expected completion time
8 indicates that the matter should have been completed by end of March 2012, and the matter could have
9 been sent to the Settlement Section as early as April 2012, but instead, the District did not take action
10 regarding the new evidence until April 2012, and did not send the matter to the Settlement Section
11 until October 2012. Accordingly, we recommend relief of interest for the period April 1, 2012,
12 through October 31, 2012.

13 Next, we contacted the Settlement Division regarding the six-month time span between
14 October 2012 and March 2013, when the case was assigned to that division, and were informed that
15 the Settlement Division concluded that the parties could not reach agreement in March 2013, and
16 informed petitioner by letter dated March 12, 2013, that his case would be returned to the normal
17 Appeals process. We find that there was no unreasonable delay during the six-month period that the
18 Settlement Division analyzed petitioner's settlement proposal and negotiated with petitioner.

19 Additionally, we find that there was no delay during the two months, from March 13, 2013,
20 through May 16, 2013 that the case was assigned to the Petitions Section for preparation of a written
21 Summary Analysis. Regarding the next four-month period until a Notice of Appeals Conference was
22 mailed to petitioner on September 13, 2013, we find that four months is well within the standard
23 timeframe for a case to be selected and scheduled for an appeals conference. We note that petitioner
24 raised several contentions on appeal and provided over 30 pages of additional documentation to the
25 Culver City District Office on January 13, 2014; and that the Culver City District Office responded to
26 this new evidence in about one-and-a-half months, on March 6, 2014. We find that there was no
27 unreasonable delay in reviewing and analyzing the additional documentation provided by petitioner.
28 The Appeals Division finished gathering information on March 6, 2014, when the Department

1 responded to the new evidence, and issued the D&R about 45 days later, on April 23, 2014, which is
2 well within the 90-day timeframe provided in the Rules for Tax Appeals of the Board of Equalization.

3 After considering the foregoing timelines of events, we recommend relief of interest only for
4 the period April 1, 2012, through October 31, 2012, for which we compute interest of \$2,947.81.

5 **OTHER MATTERS**

6 None.

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8 Summary prepared by Gary A. Lomazzi, Business Taxes Specialist II
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